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SIPDIS

SENSITIVE

TREASURY FOR OASIA - DAS LEE AND SSEGAL
NSC FOR RENIGAR
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E.O. 12958: N/A

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SUBJECT: BRAZIL CENTRAL BANK DEPUTY GOVERNOR QUILTS AMID
SCANDAL

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11. (U) Deputy Central Bank Governor for Monetary Policy Luiz Candiota resigned July 28 after press allegations the previous weekend of improprieties in both Candiota's and Central Bank (CB) President Henrique Meirelles' pre-2003 Brazilian income-tax returns. In Meirelles' case, the chief accusation is simply that he should have filed a Brazilian tax return for 2001, i.e., that he was not entitled to claim physical residence in the U.S. from 1997 through 2001 as grounds for exemption from Brazilian income tax, since that year he registered himself with the Goias state electoral committee as locally domiciled -- a standard requirement for his planned 2002 race for a seat in Brazil's Congress. Meirelles defended himself in an immediate Central Bank press release, pointing out that he had paid all U.S. taxes due while living in the United States and asserting that he had merely maintained a domicile in Brazil for electoral purposes, which did not require him to pay Brazilian taxes during that period.

12. (U) The charges against Candiota were of a different order, involving apparent multiple cases of unreported financial transfers, typically in the low-to-mid six figures (U.S. dollars), some of them to offshore tax havens, through a New York-based bank alleged to be a known money-laundering conduit. Like Meirelles, Candiota also denied any illegality in his conduct. However, he did not publicly offer specifics to rebut the allegations and apparent detail of documentation that he had hidden assets abroad. In contrast to the immediate CB press release upholding Meirelles, the GoB made no public move on Candiota's behalf; in fact, comments on the case by Justice Minister Bastos were widely seen as having the opposite effect. In his letter of resignation, Candiota stated that despite the allegations, untruth, he felt "personally violated" by them and was no longer willing to remain in the job under those circumstances. He also argued it was best for him to leave quickly lest extended scandal harm the Central Bank or unsettle financial markets.

13. (SBU) A senior advisor to the Central Bank Board gave no credence to the allegations against Candiota and Meirelles in a July 28 conversation with Emboff and argued that the media to-do over the two top CB figures was simply an example of election-year politics, driven by opposition efforts to discredit the Lula administration. He predicted more of the same as October municipal elections draw near.

14. (SBU) Simultaneous with the announcement of Candiota's resignation, Meirelles, after consultation with Finance Minister Palocci, nominated CSFB Managing Director Rodrigo Azevedo to replace him. Azevedo is well and favorably known to the Embassy and to Consulate Sao Paulo as a keen, and orthodox economic analyst with impeccable academic credentials. His nomination has drawn universal plaudits from the financial community, and markets responded calmly both to Candiota's resignation and replacement. The nomination will require Senate confirmation, tentatively scheduled for the second or third week of August. At this point the only obvious obstacle to a quick confirmation is the greater difficulty of obtaining a quorum during this electoral season.

15. (SBU) Comment: Candiota's exit is plainly a GoB effort quickly to put this scandal in the past, and defuse any danger to Meirelles himself, which at this stage seems to be the likely outcome. Had these charges surfaced two-and-a-half months ago, amidst the sustained bad economic news and criticism of the Central Bank's tough monetary line that prevailed at the time, it might have caused serious political and market damage. But the improved economic data and trends since then give the GoB and Meirelles much more political leeway. Indeed, the very fact that the GoB gave Meirelles full authority to pick Candiota's replacement

usefully reinforces the perception of de facto Central-Bank autonomy, even in the absence of formal CB "independence," which Finance Minister Palocci recently re-announced as a key prospective GoB legislative goal for 2005.

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